FOR ARGUMENT

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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-335

OPPENHEIMER FUND, INC., OPPENHEIMER MANAGEMENT CORP., OPPENHEIMER & CO., LEON LEVY, JACK NASH, EDMUND T. DELANEY AND EMANUEL CELLER,

Petitioners,

v.

IRVING SANDERS, EGON TAUSSIG, MICHAEL SHAEV AND RITA SHAEV,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

February 24, 1978

(Counsel on Inside of Cover)

Of Counsel:

GUGGENHEIMER & UNTERMYER
80 Pine Street
New York, New York 10005
(212) 344-2040

ALFRED BERMAN
LEON H. TYKULSKER
RICHARD P. ACKERMAN
NORMAN L. GREENE
80 Pine Street
New York, New York 10005
(212) 344-2040
Attorneys for Petitioners
Oppenheimer Management Corp.,
Oppenheimer & Co.,
Leon Levy,
Jack Nash

WEISMAN, CELLER, SPETT, MODLIN, WERTHEIMER & SCHLESINGER
425 Park Avenue
New York, New York 10022
(212) 371-5400

GERALD GORDON
425 Park Avenue
New York, New York 10022
(212) 371-5400
Attorneys for Petitioner
Oppenheimer Fund, Inc.

THACHER, PROFFITT & WOOD
40 Wall Street
New York, New York 10005
(212) 483-5800

JOHN F. DAVIDSON
DANIEL E. KIRSCH
40 Wall Street
New York, New York 10005
(212) 483-5800
Attorneys for Petitioners
Edmund T. Delaney,
Emanuel Celler

INDEX

PAGE

Preliminary Statement 1

I. Ascertaining the Names and Addresses of Class Members Is an Integral Part of Satisfying the Notice Requirements Under Rule 23(c)(2) and the Costs of Doing So Must Therefore Be Borne by Plaintiffs Under *Eisen IV*. Plaintiffs' Contentions to the Contrary Are Fallacious 3

II. In the Circumstances Here Present, the District Court Did Not Have Discretion Under the Discovery Rules to Depart From the Rule of *Eisen IV* 7

III. There Are No Special Circumstances Here Present Which Warrant Constricting the Salutary Rule of *Eisen IV* 12

CONCLUSION 21

TABLE OF AUTHORITIES

Cases:

Appleton Electric Co. v. *Advance-United Expressways*, 494 F.2d 126 (7th Cir. 1974) 6

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 10

Burstein v. *Slote*, 12 F.R. Serv.2d 577 (S.D.N.Y. 1968) 9n

Chevalier v. *Baird Savings Ass'n*, 72 F.R.D. 140 (E.D. Pa. 1976) 9n

PAGE

Dionne v. *Springfield School Committee*, 340 F.Supp. 334 (D. Mass. 1972) 6

Dolgow v. *Anderson*, 43 F.R.D. 472 (E.D.N.Y. 1968) ..18, 19

Eisen v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974) (*"Eisen IV"*) 2, 2n, 3, 3n, 4, 5, 6, 7, 11, 12, 14, 15, 16, 18, 19, 20

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976)..... 18

In re Nissan Motor Corp. Antitrust Litigation, 552 F.2d 1088 (5th Cir. 1977) 3n, 4, 13

In re Penn Central Securities Litigation, 560 F.2d 1138 (3rd Cir. 1977) 8n

Pepper v. *Litton*, 308 U.S. 295 (1939) 15

Piper v. *Chris-Craft Industries, Inc.*, 97 S.Ct. 926 (1977) 16

Popkin v. *Wheelabrator-Frye, Inc.*, 1975-6 CCH *Fed. Sec. L. Rep.* ¶ 95,411 (S.D.N.Y. 1976) 3n

Santa Fe Industries, Inc. v. *Green*, 97 S.Ct. 1292 (1977) 16

Securities and Exchange Commission v. *Chenery Corp.*, 318 U.S. 80 (1943) 15

In re Sugar Industry Antitrust Litigation, 73 F.R.D. 322 (E.D. Pa. 1976) 9n

Tannenbaum v. *Zeller*, 552 F.2d 402 (2d Cir. 1977) 14n, 16n

TSC Industries, Inc. v. *Northway, Inc.*, 426 U.S. 438 (1976) 18

United States v. *Byrum*, 408 U.S. 125 (1972) 15

Zahn v. *Transamerica Corp.*, 162 F.2d 36 (3rd Cir. 1947) 15

Statutes and Rules: PAGE

Investment Company Act of 1940, 15 U.S.C. §80a-1 *et seq.* 15, 16n

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 18

Fed. Rule Civ. Proc. 23, 28 U.S.C. 1, 2, 2n, 3, 4, 6, 7, 8, 9, 10n, 11

Fed. Rule Civ. Proc. 26, 28 U.S.C. 7, 8, 9

Fed. Rule Civ. Proc. 33, 28 U.S.C. 10, 11

Fed. Rule Civ. Proc. 34, 28 U.S.C. 7, 10, 11

U.S. Sup. Ct. Rule 40 1

Miscellaneous:

Bell, "The Pound Conference Follow-Up: A Response From the United States Department of Justice," 76 F.R.D. 320 (1978) 10

Class Action Study, prepared for U.S. Senate Commerce Committee, 93rd Congress, 2nd Session (1974), reported in H. Newberg, *Class Actions*, Vol. 5, Appendix to Chapter 27, p. 1442 *et seq.* (McGraw-Hill 1977) 6n

Comment, "Allocation of Identification Costs in Class Actions: *Sanders* v. *Levy*," 91 Harv. L. Rev. 703 (1978) 5n, 7n, 14n

Ellsworth, "Disgorgement in Securities Fraud Actions Brought by the SEC," 1977 Duke Law Journal 641 (1977) 17n

Erickson, "Responses of the American Bar Association to the Pound Conference," 64 A.B.A. Journal 49 (January 1978) 10n

PAGE

Investment Companies, L. T. Wessman ed., Arthur Wiesenberger Services (29th ed. 1969) 19n

3 L. Loss, *Securities Regulation* (2d ed. 1961)..... 17n

Lundquist and Schechter, "The New Relevancy: An End to Trial by Ordeal," 64 A.B.A. Journal 59 (January 1978) 10n

SEC Investment Company Act Release No. 5847 (October 21, 1969) 18n

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Preliminary Statement

Pursuant to Rule 40 of this Court, petitioners ("defendants") submit this reply to the brief of respondents ("plaintiffs").

The question to be decided is whether in a class action under Rule 23(b)(3),[1] any of the defendants can be required to bear the expense of special programming required to identify and assemble the names and addresses of the members of the class that plaintiffs propose to

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[1] "Rule . . ." refers to the Federal Rules of Civil Procedure.

represent and to whom the initial class notice required by Rule 23(c)(2) is to be sent.

Plaintiffs urge that this expense was properly imposed on defendant Fund on the basis of three principal arguments, all of which we submit are entirely lacking in merit.

1. Underlying all of plaintiffs' arguments is the erroneous premise that identification of the names and addresses of class members for class notice purposes is not an integral part of the notice procedure and therefore the decision of this Court in *Eisen IV*[2] is inapplicable.

2. Plaintiffs place their major emphasis on attempting to establish that the District Court had discretion under the Federal discovery rules to impose this expense on defendant Fund, despite *Eisen IV*, and even though the decision as to this expense was not made in connection with any proceeding under the discovery rules, which, if applicable, would not authorize shifting the expense to the Fund.

3. Plaintiffs also contend that if *Eisen IV* were applicable and would usually require plaintiffs to bear the expense, this case should be deemed an exception for two reasons: (1) defendants' opposition to plaintiffs' combined proposal for broadcast mailing and class reduction; and (2) the purported fiduciary relationship between the Fund and plaintiffs—factors which in the circumstances here present have no bearing on the question of proper allocation of notice costs.

[2] *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974).

I.

Ascertaining the Names and Addresses of Class Members Is an Integral Part of Satisfying the Notice Requirements Under Rule 23(c)(2) and the Costs of Doing So Must Therefore Be Borne by Plaintiffs Under *Eisen IV*. Plaintiffs' Contentions to the Contrary Are Fallacious.

In *Eisen IV*, this Court held that in the usual class action, plaintiffs must bear the costs of notifying class members under Rule 23(c)(2).

The notice required by Rule 23(c)(2) involves at least eight essential components, including ascertaining the names and addresses of class members, marking them on the envelopes into which the notice will be stuffed, and affixing postage on these envelopes. (Petitioners' Brief, pp. 26ff).[3] A substantial majority of relevant cases have treated the process of identification as an integral part of the notice process.[4] Indeed, the specific language of the Rule itself concerning notice points to the same conclusion in requiring "individual notice to all members who can be

[3] Petitioners' Brief and Respondents' Brief will be cited as "Pet. Br." and "Resp. Br."

[4] Plaintiffs misconstrue (at Resp. Br. pp. 32-33) the cases cited by defendants (at Pet. Br. p. 26) for the proposition that a substantial majority of cases regard identification as part of notice. That some of these cases allocated identification costs to defendants does not mean that identification was treated as separate from notice. A number of the cases preceded *Eisen IV*, and some courts then assumed they had discretion to allocate between plaintiff and defendant any notice costs, including identification costs. Contrary to plaintiffs' implications (Resp. Br. pp. 32-33), a number of post-*Eisen IV* cases have regarded it as plaintiffs' obligation to pay the expense of class member identification. See *e.g.*, *Popkin* v. *Wheelabrator-Frye, Inc.*, 1975-6 CCH *Fed. Sec.L.Rep.* ¶ 95,411 (S.D.N.Y. 1976); *In re Nissan Motor Corp. Antitrust Litigation*, 552 F.2d 1088 (5th Cir. 1977).

identified through reasonable effort." (Emphasis supplied). As was properly observed by the dissent below, "Notification posits identification which is an inseparable part of the process." 558 F.2d at 652; PA-50a.

Plaintiffs have no adequate reply to any of the foregoing. Instead, they urge that *Eisen IV* applies or should apply only to a fraction of all notice costs (which in this case would be a minor portion of the total), stating (at Resp. Br. p. 22): "Indeed, *Eisen IV* did not even deal with the question of allocating the costs of obtaining information as to the names of class members." Any such restrictive reading disregards the entire thrust of the decision that plaintiffs must pay all expenses of the notice process, including those relating to identification of class members. Thus this Court declared that "the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit" (417 U.S. at 179), and that "[i]n the absence of any support under Rule 23, [plaintiff's] effort to impose the cost of notice on [defendants] must fail." (417 U.S. at 178).

Similarly erroneous is plaintiffs' reading of the recent Fifth Circuit decision, *In re Nissan Motor Corp. Antitrust Litigation*, 552 F.2d 1088 (5th Cir. 1977), in which they urge that this decision did not establish a rule requiring plaintiffs to bear the expense of identification.[5] (Resp. Br. p. 31). Their contention ignores *Nissan*'s statement at 552 F.2d at 1102:

> "Upon commencing a class action, the class representatives must be prepared to accept the concomitant responsibility of identifying absentee class members as well as paying the costs of their individual notice."

[5] Plaintiffs also misread *Nissan* as applying discovery rules in connection with Rule 23 matters (Resp. Br. p. 31). In fact, *Nissan* rejected any such application of those rules. See Pet. Br. p. 46.

Plaintiffs suggest that identifying and assembling the names and addresses of class members may be distinguishable from other aspects of notice on the grounds that access to material concerning identification is controlled by defendants while the preparation and mailing of a notice is controlled by plaintiffs (Resp. Br. pp. 23-4). This purported distinction is beside the mark. Control of access has no bearing on who properly should bear the expense of acquiring the information. Plaintiffs would confuse who may best arrange for a task to be done with who should pay for it.[6]

Perhaps in recognition of the irrelevance of this distinction, plaintiffs then attempt to justify abandonment of *Eisen IV* on the hypothetical basis that there is "a significant *potential* for abuse" by whoever controls access. (Resp. Br. p. 24). This "potential" for abuse is of the same spurious quality as the "potential" issue upon which the en banc decision sought to justify application of the discovery rules. (See Pet. Br. p. 50). There is not even a scintilla of evidence in this case of any such abuse by defendants or any attempt on their part to obstruct access to shareholder records; nor do plaintiffs make such a claim. On the contrary, defendants have been and remain fully willing to have the tasks needed to identify class members performed by its transfer agent at plaintiffs' expense. As the dissent below noted (558 F.2d at 653; PA-52a):

> "The raw tape data from which the proper list can be ascertained is fully available to the plaintiffs. The

[6] See Comment, "Allocation of Identification Costs In Class Actions: *Sanders* v. *Levy*," 91 Harv. L. Rev. 703, 712 (1978): "[T]he question of which party has the easiest task of gathering the [identification] information is relevant to the question of who should perform the task *but not always relevant to the question of who should pay for its performance.*" (Emphasis supplied.)

> only issue is who is to pay the expense of the special programming necessary to make it usable."

Moreover, if there should be obstruction or other abuse, the District Court has ample authority to devise appropriate sanctions. See *Appleton Electric Co.* v. *Advance-United Expressways*, 494 F.2d 126 (7th Cir. 1974).

Plaintiffs present no sound basis for excluding the costs of class member identification for the purpose of giving notice under Rule 23(c)(2) from the salutary rule of *Eisen IV* that all notice costs are to be borne by plaintiffs if they wish to obtain the advantages of a class action. Nor is such exclusion warranted by consideration of policy factors relating to class actions. As was emphasized by the comments of numerous respected practitioners and such distinguished jurists as Judges Medina, Friendly and Weinfeld (Pet. Br. pp. 37-44), class actions are not an unmixed blessing. Similarly, Judge Wyzanski has referred to the overburdening of his court by "frivolous 'class suits.'" *Dionne* v. *Springfield School Committee*, 340 F.Supp. 334, 335 (D. Mass. 1972). Plaintiffs may claim that these comments present a "largely unfounded description of class actions" (Resp. Br. p. 35) only by disregarding the realities of class action practice and the increasingly heavy burdens class actions impose on the courts as disclosed by statistics from the Administrative Office of the United States Courts.[7]

[7] The "comprehensive" study on which plaintiffs rely to refute defendants' criticisms of class actions, the "Class Action Study" (see Resp. Br. pp. 39-41), fails to do so. The Study rests on statistics pertaining to relatively few cases and does not, of course, cover recent developments after publication, during the last 4 years. Among other things, the Study is unreliable concerning the impact of litigation expenses on the amounts of class recoveries, since in most of the cases studied, plaintiffs did not incur notice expenses, and where they did, the expenses were minimal. (Class Action Study, pp. 15-17).

We submit there is no sound basis for attempting to fragment the integral components of the notice process. To do so will not only dilute *Eisen IV* but ultimately will lead to the result that defendants will in substantial part be financing suits against themselves—a result which *Eisen IV* does not countenance.[8]

II.

In the Circumstances Here Present, the District Court Did Not Have Discretion Under the Discovery Rules to Depart From the Rule of *Eisen IV*.

In *Eisen IV*, this Court held: "In the absence of any support under Rule 23, petitioner's effort to impose the cost of notice on respondents must fail." (417 U.S. at 178). Plaintiffs here, having been no more successful than the *Eisen* plaintiff in finding support under Rule 23, have looked

The Study, which was prepared by students for the Georgetown University Law School Law Journal for publication in 1974, and reprinted in H. Newberg, *Class Actions*, Vol. 5, Appendix to Chapter 27, p. 1442 *et seq.* (McGraw-Hill 1977), contains a "national" segment based on responses to questionnaires pertaining to a limited number of cases, and a District of Columbia segment, also analyzing a limited number of cases. Although not noted by plaintiffs, conclusions drawn in each segment of the Study sometimes rest on data pertaining to substantially fewer than the total number of cases involved in the segment. Plaintiffs also repeatedly fail (at Resp. Br. pp. 39-40) to note from which segment they are deriving their excerpted conclusions and statistics.

[8] Where there is scant likelihood that defendants, even if they prevail, will be reimbursed for the expenses of identification, imposing that burden on them raises a due process issue. See Pet. Br. pp. 24-25, especially at fn. 17. See also Comment, *supra*, 91 Harv.L.Rev. 703, 711 (1978):

> "Absent some meaningful guarantee of reimbursement by plaintiffs, which will vary with the facts of each case, a due process problem might be raised if defendants were required to pay identification costs, thereby, in effect, financing the class action against themselves."

elsewhere and purport to find support in discovery Rules 26 and 34. For reasons set forth at Pet. Br. pp. 44-62, the discovery rules should not be misapplied as plaintiffs here propose.

1. Plaintiffs did not follow the procedures required to invoke the federal discovery rules to obtain the names and addresses of class members, despite plaintiffs' contentions to the contrary (Resp. Br. pp. 10, 34), and the District Court did not purport to act pursuant to these rules in ordering the Fund to pay the costs of identification. Instead, the issue of who was to pay these costs arose in connection with plaintiffs' motion for class certification under Rule 23(c)(1); and both the District Court and plaintiffs viewed the question of identification costs as one arising under Rule 23.[9]

2. Even if the issue of discovery were not precluded from consideration because not properly raised in the District Court,[10] the names and addresses of class members are not discoverable by plaintiffs for the purpose of giving notice under Rule 23. The fundamental reason is that plaintiffs do not seek information or knowledge as required by Rule 26(b)(1). On the contrary, they seek only to have the Fund pay for the transfer agent's extensive services (as

[9] Thus, at Record Document, No. 94 (at p. 11), referred to by plaintiffs at Resp. Br. p. 10, fn. 4, plaintiffs asked the District Court to impose the expense of identification on defendants in their class certification motion *under Rule 23*. Further, as the dissent below noted:

> "The plaintiffs have never sought discovery relief under Rule 34. In the memoranda submitted by the plaintiffs to Judge Griesa prior to his opinion below there is no mention of Rule 34. Judge Griesa expressly and correctly perceived the issue as being 'who is to bear certain expenses in connection with the giving of notice.' *Sanders* v. *Levy*, 69 Civ. 1242, Slip op. at 2 (S.D.N.Y. May 15, 1975)." 558 F.2d at 653; PA-51a.

[10] See *In re Penn Central Securities Litigation*, 560 F.2d 1138 (3rd Cir. 1977).

described at Pet. Br. p. 8) in providing the addresses to be affixed to the envelopes transmitting the class action notice to members of the class. There is no basis for believing that plaintiffs or their attorneys would even look at, let alone require knowledge of, those 121,000 names and addresses.

Plaintiffs' contention that the inapplicability of discovery to class member identification would make discovery inapplicable to other matters germane to the requirements for maintaining a class action suit under Rule 23 is fallacious. Information about such other matters as the numerousness of the class, the existence of common questions of fact and law and their predominance over individual questions may be discoverable precisely because these are matters which must be established if the class action is to be maintained. Similarly, information may be required regarding the nature of the best notice practicable so that the court may determine the extent of the effort required for notice to class members. While discovery for these purposes may be in compliance with the requirements of Rule 26, not so is the attempted use of discovery for the purpose of shifting the costs of the basic task of notice assigned to plaintiffs under Rule 23. Nor is there justification for resort to fanciful "issues" that are artificially created by superficial reasoning of the type that the dissenters characterized as "an exercise in sophistry." 558 F.2d at 653; PA-51a.[11]

[11] To the extent *Chevalier* v. *Baird Savings Ass'n*, 72 F.R.D. 140 (E.D. Pa. 1976), would permit the imposition of identification expenses on defendants in class actions, it appears to conflict with a decision in the same district, *In re Sugar Industry Antitrust Litigation*, 73 F.R.D. 322, 359-360 (E.D. Pa. 1976). The issue of expenses did not arise in *Burstein* v. *Slote*, 12 F.R. Serv.2d 577 (S.D.N.Y. 1968), where the issue of identification arose in connection with an oral deposition. Both decisions appear to have been wrongly decided insofar as they permitted discovery of the names and addresses of class members.

The efforts of plaintiffs and of the en banc majority to press for a more expansive reading of the discovery rules fly in the face of the ever-mounting concern of the Bench and the Bar with respect to the excessive latitude of the present discovery rules and procedures. Thus this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741-2 (1975), warned of the "threat of extensive discovery" which in and of itself may force settlements and the "potential for possible abuse of the liberal discovery provisions" which may "exist in this type of case [i.e. securities litigation] to a greater extent than they do in other litigation." Similarly, the Attorney General of the United States has recently articulated his views "that a high priority should be given to eliminating abuses in the use of pretrial discovery procedures. . . ." Bell, "The Pound Conference Follow-Up: A Response From The United States Department of Justice," 76 F.R.D. 320, 328 (1978).[12]

3. Even if the discovery rules were applicable, the only relevant rule is Rule 33(c), which was designed to deal with the type of situation here present, where the burden of deriving the names and addresses from the existing material is essentially the same for both sides. Where, as here, defendants freely permit plaintiffs to have access to the relevant material, Rule 33(c) requires plaintiffs to bear the expenses involved in such derivation. Plaintiffs' repeated reference to the discretion of the District Court

[12] The Attorney General further stated (at 76 F.R.D. 329): "The Office for Improvements in the Administration of Justice is studying the problems raised by class actions and developing proposals for remedying the more serious difficulties which arise under F.R. C.P. 23(b)(3)." Several of those difficulties are specifically discussed. See also Lundquist and Schechter, "The New Relevancy: An End to Trial by Ordeal," 64 A.B.A. Journal 59 (January 1978); Erickson, "Responses of the American Bar Association to the Pound Conference," 64 A.B.A. Journal 49, 52 (January 1978).

cannot disguise or justify the Court's failure to apply the principle embodied in Rule 33(c). Nor can plaintiffs' belated resort to Rule 34 disguise the fact that Rule 34 does not and was never intended to require the production of the material sought by plaintiffs, which does not yet exist and must first be created by extensive and painstaking effort. (See Pet. Br. pp. 53-62). Nothing in Respondents' Brief warrants a contrary conclusion.

4. Plaintiffs' attempt to evade the requirements of Rule 23 by resort to the discovery rules was the subject of cogent comment in the dissent below, which merits repetition:

> "In *Eisen IV* the Court stated, 'The usual rule is that a plaintiff must initially bear the cost of notice to the class.' *Id.* at 178. . . . [T]he majority has decided that obtaining the names and addresses of the prospective class is not part of the notification process mandated by Rule 23(c)(2) but is rather within a discovery process governed by an amalgam of Rules 26(b)(1) and 34. As a matter of logic this is bewildering. The only purpose of the plaintiffs here in obtaining the data is to notify the class; it is an essential and unavoidable step in the notice giving process. . . . The majority now creates in effect a bicephalous rule which is anomalous. . . . As *Eisen IV* held, 'the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit.' 417 U.S. at 179, 94 S. Ct. at 2153. We cannot appreciate how it can be reasonably held that the expense incurred in producing the list of addresses is distinguishable from the expense of preparing and mailing the notice." 558 F.2d at 652; PA-48a-49a.

It was in the light of this sound analysis that the dissenters below rejected the claims that *Eisen IV* supported

the views of plaintiffs and the en banc majority, and stated: "We can only conclude that the majority while purporting to follow *Eisen IV* is in fact *flouting* its holding." 558 F.2d at 653, PA-52a. (Emphasis added).

III.

There Are No Special Circumstances Here Present Which Warrant Constricting the Salutary Rule of *Eisen IV*.

If plaintiffs are not permitted to bypass *Eisen IV* by misapplication of the discovery rules, then they ask this Court to so constrict the scope of that decision as to make it inapplicable to this case, with the consequence, we believe, that the rule will be lost in the exceptions.

Plaintiffs contend that there are two factors which justify abandonment of *Eisen IV*—first, the additional costs allegedly attributable to defendants by reason of their opposition to plaintiffs' proposal for broadcast mailing and class redefinition; and second, the alleged fiduciary relationship between defendants and plaintiffs. Neither of these factors warrants the result plaintiffs seek.

1. *Defendants' opposition to a broadcast mailing to a reduced class did not necessitate additional costs.* Defendants opposed the combined proposal primarily because of the damage that was likely to be caused to the Fund and its shareholders by a broadcast mailing (Pet. Br. pp. 32ff). This was a legitimate concern in a period of highly unsettled market conditions when net redemptions by mutual fund shareholders exceeded sales (Pet. Br. pp. 10, 32). It was substantiated by record evidence to the satisfaction of the 3-judge Panel,[13] which correctly noted the substantial

[13] 558 F.2d at 641; PA-21a.

difference in impact of an official class notice as compared with incidental mention in prospectuses and proxy statements where attention would be focused on entirely different matters. Neither the District Court itself nor the 3-judge Panel in the Circuit Court found plaintiffs' application for a broadcast mailing acceptable in the circumstances here present, a conclusion which was followed in *In re Nissan Motor Corp. Antitrust Litigation*, 552 F.2d 1088, 1099 (5th Cir. 1977).[14]

Broadcast mailing was tied-in to plaintiffs' proposal to reduce the class by some 18,000 shareholders—a proposal which the District Court itself rejected as "arbitrary", saying: "I can simply say that in my view, plaintiffs' proposal would involve an arbitrary reduction in the class." 20 F.R.Serv.2d 1218, 1221; PA-5a-6a.

Thus, the District Court reached the paradoxical conclusion that although plaintiffs' proposal for class reduction was arbitrary and improper, nevertheless defendants were to be penalized because of their opposition to this proposal. The District Court's rationale appears in a single laconic statement:

> "But here the expense is relatively modest and it is defendants who are seeking to have the class defined in a manner which appears to require the additional expense." 20 F.R.Serv.2d at 1221; PA-6a.

The comment of the dissent below bears repetition:

> "The determination of the scope of the class was on the merits. We cannot agree that by opposing an improper

[14] Plaintiffs' speculations as to defendants' motivation in opposing the proposal for broadcast mailing and class reduction are both irrelevant and erroneous. Plaintiffs' misguided "presumption" that defendants were motivated by a desire to obtain the maximum res judicata effect is discussed at Pet. Br. pp. 31-32.

class a defendant thus becomes liable for any increased costs of notification. The class cannot become proper only if the defendant bears the costs of notifying the members. If this is to be the law the opportunities for abuse become obvious." [15] 558 F.2d at 654; PA-54a.

What stands out in the District Court's decision is the absence of any reference to this Court's prior decision in *Eisen IV*, the absence of any discussion as to why the principles of that case might be inapplicable, and above all the characterization of expenses of more than $16,000 (predicated on 1973 prices) for class member identification as "relatively modest" without any cognizance that *Eisen IV* prohibits tailoring the allocation of class notice costs to the pocketbooks of the respective parties. 417 U.S. at 176.[16]

In the circumstances here present, any additional notice costs may not be attributed to defendants.[17]

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[15] *Cf.* Comment, *supra*, 91 Harv. L. Rev. 703, 712 (1978):

"[T]he dissent . . . rightly pointed out that defendants' opposition to an improper class definition should not subject them to increased costs. In addition, under the facts of this particular case, plaintiffs also successfully opposed defendants' attempted class redefinition; *indeed, it was plaintiffs' initial class definition that ultimately was accepted.*" (Emphasis added).

[16] It need hardly be emphasized that the Fund, like all mutual funds, is a "mere shell", a pool of assets that belongs to the individual investors owning fund shares. *Tannenbaum* v. *Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). In this case, the average ownership of the Fund's assets by its 171,000 shareholders was the modest sum of approximately $3,000 per shareholder.

[17] Plaintiffs inaccurately contend that the proposed redefinition of the class would have eliminated some issues raised by defendants' claims against class members who bought fund shares and then redeemed them. In fact, a number of class members, including Taussig (A-106-108), a named plaintiff, redeemed some of their shares and retained some, thus remaining in the class, so that with respect to them there would have been no simplification of issues.

2. *The relationship between the parties does not call for any change in the requirement that plaintiffs shall bear all costs of notice.* Plaintiffs' second main argument for abandoning *Eisen IV* is based largely on the fiduciary relationship between plaintiffs and defendants, which plaintiffs derive from the provisions of the Investment Company Act of 1940, 15 U.S.C. §§80a-1 *et seq.* (Resp. Br. pp. 55-6).

As Justice Frankfurter remarked, ". . . to say that a man is a fiduciary only begins analysis. . . ." *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80, 85-86 (1943). This note of caution is especially pertinent in the instant case, which is concerned with theoretical errors of judgment in methods of determining the fair value of nonmarketable securities and not with corporate insiders seeking to profit at the expense of disadvantaged shareholders.

Corporate managements are, of course, fiduciaries in their dealings with the corporation's security holders and assets. This is true by virtue of a great body of judicial decisions, as well as by a variety of state and federal statutes. See e.g. *United States* v. *Byrum*, 408 U.S. 125, 137-8 (1972); *Pepper* v. *Litton*, 308 U.S. 295, 306-7 (1939); *Zahn* v. *Transamerica Corp.*, 162 F.2d 36, 42-3 (3d Cir. 1947). The fact that corporate managements must observe fiduciary standards in their dealings with the corporation and security holders surely does not render them presumptively guilty, any more than other class action defendants, of the unproved and unsupported accusations of any shareholder who lends his name to a class action complaint, and thereupon demands that any or all the defendants—let alone the defendant corporation—should forthwith finance the prosecution of his lawsuit. If, without more, this fiduciary relationship between corporate management and its shareholders is sufficient to warrant imposing notice costs

on defendants, then it is dubious that *Eisen IV* would apply in any but a relatively few class actions. We do not believe that such a result was contemplated by this Court.

Moreover, we do not believe that the fiduciary relationship referred to in the Investment Company Act was intended by Congress to be applicable to notice costs under Rule 23. As this Court has emphasized recently on two occasions, the provisions of the federal securities laws should not be expanded to serve what are at best subsidiary or incidental purposes of the legislation. *Santa Fe Industries Inc.* v. *Green*, 97 S.Ct. 1292, 1303 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 97 S.Ct. 926, 949 (1977).

The contrived emphasis of the plaintiffs upon the fact that the Fund and its management are subject to the comprehensive legislation embodied in the Investment Company Act would seem to imply that especially because investment companies and their managements are so extensively and thoroughly supervised by the Securities and Exchange Commission under that statute, as well as under the several other securities laws administered by that agency,[18] the plaintiffs are entitled to draw upon the treasury of the Fund to finance their class litigation, from which the Fund can derive no financial benefit whatever.[19]

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[18] "Congress sought to minimize the possibilities of abuse of position by mutual fund managers by means of the Investment Company Act of 1940, 15 U.S.C. §80a-1, *et seq.* This statute expanded the disclosure provisions already applicable to the industry under the Securities Act of 1933, 15 U.S.C. §77a, *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. §78a, *et seq.*, and imposed specific requirements as to the structure and operation of mutual funds." *Tannenbaum* v. *Zeller*, 552 F.2d 402, 406 (2d Cir. 1977).

[19] The only cause of action asserted by plaintiffs from which the Fund conceivably might derive financial benefit if plaintiffs prevail fully, is the derivative claim relating to alleged overpayments by the Fund upon redeeming shares and the alleged overpayments in service fees to the Manager. However, the derivative claim is not related to the class notice costs, the issue here on review. The claim regarding redemptions has been estimated by plaintiffs as possibly aggregating $226,000, that regarding services fees as perhaps $75,000. Record Document, No. 118, p. 11-12. If plaintiffs prevail, however, the Fund stands to lose far more than this by reason of the cross-claims asserted against it by other defendants. (A-66-67; 89-90).

However, logic and realism require exactly the contrary conclusion. Precisely because the Fund and its management are subject to the intensive regulation of this especially comprehensive statute, under the continuous detailed supervision of one of the nation's leading regulatory agencies, the completely unsubstantiated claims of these plaintiffs should receive far less encouragement and support than in litigations where the defendants are subject to relatively little or no regulation. The Securities and Exchange Commission has not hesitated to institute and prosecute litigations when it has reason to believe that any applicable statute has been violated or that managerial and other fiduciary obligations have been disregarded.[20]

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[20] Indeed as prosecutor, the SEC occupies a privileged position over private litigants. Thus Ellsworth, "Disgorgement in Securities Fraud Actions Brought By The SEC," 1977 Duke L. Journal 641, 650 (1977), noted:

> "A good example of the SEC's privileged position is found in *SEC* v. *Petrofunds, Inc.*, where the defendants argued that the accounting and disgorgement of profits requested by the Commission in a suit for alleged fraud on investors in oil and gas drilling properties entitled the defendants to a trial by jury. The disgorgement of profits was identified with the relief that a private litigant might seek under the securities laws or in traditional common law actions. But the court dismissed this argument, saying that disgorgement when sought by the SEC is necessary to effectuate enforcement of the securities laws. A jury trial, therefore, was not required."
>
> It may be this "privileged position" that Professor Loss had in mind when he stated in his 1961 treatise: "An even more effective device than the class action would be direct enforcement by the Commission of restitution to the victims of violations of the statutes." 3 L. Loss, *Securities Regulation* (2d ed. 1961) at p. 1824.

Plaintiffs attribute considerable significance to the Supreme Court's footnote reference in *Eisen IV* to *Dolgow* v. *Anderson*,[21] as an example of a possible exception to the *Eisen IV* rule, even though the Court emphasized that "we, of course, express no opinion of the proper allocation of the cost of notice" even in comparable situations. (417 U.S. at 178, n.15).

For good and sufficient reason, the instant case is not comparable with *Dolgow*. First, the test advanced in *Dolgow* for shifting notice costs to the fiduciary defendant required a preliminary hearing and findings of a *prima facie* breach of fiduciary duty and in addition, a finding that the fiduciary was better able to bear the costs. (Pet. Br. pp. 35-6). Any such comparable procedures and finding were, of course, expressly ruled out in *Eisen IV*. Even if they were permissible, the possibility that plaintiffs' complaints, based on alleged violations of SEC Rule 10b-5 and other SEC administered rules and statutes, could survive judicial scrutiny and emerge with a finding of *prima facie* breach of fiduciary duty, have been further sharply reduced, if not obliterated, by at least two of the Supreme Court's recent, highly pertinent decisions: *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), clarifying the test for actionable "deception" under Rule 10b-5, and *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), clarifying the test for actionable "non-disclosure" under other sections and rules.[22]

[21] 43 F.R.D. 472 (E.D.N.Y. 1968). See Pet. Br. p. 34.

[22] Any intimation that purchases by investment companies of restricted securities was in any way unusual during the relevant 1969-1970 period, is contrary to the facts. The Securities and Exchange Commission has stated that registered investment companies held in excess of $4.2 billion of restricted securities as of the end of 1968 (SEC Investment Company Act Release No. 5847, October 21, 1969.) Moreover, their favor with the investing public was such that a then newly-formed investment company, Fund of Letters, Inc., raised $55 million of capital in a public offering in 1968 for an investment portfolio to consist predominantly of restricted securities. *Investment Companies*, L. T. Wessman, ed., Arthur Wiesenberger Services (29th ed. 1969), p. 403.

Second, *Dolgow* entailed the most serious type of fraud and breach of fiduciary obligations. There, corporate officers and directors were accused of manipulating the price of the defendant corporation's shares so that they could sell their shares at artificially inflated prices. Here, the alleged misconduct, if any, consisted essentially of errors of judgment as to methods of evaluating the fair value of restricted securities and an alleged failure to describe adequately in the Fund's prospectuses the nature of such investments and methods of valuation.

The other theoretical exception in *Eisen IV* that the Court mentioned expressly related to pre-existing "fiduciary duties . . . *as in a shareholder derivative suit*" (417 U.S. at 178). (Emphasis supplied.) In derivative suits, the corporation might at least stand to realize large and meaningful financial benefits if the shareholder plaintiffs were ultimately upheld. Here, the Fund will recover nothing if the plaintiff class recovers on the class claims (Pet. Br. pp. 34-5) and may instead be liable on cross claims to the unsuccessful defendants (Pet. Br. p. 6). See p. 20, *infra*.

Furthermore, this Court's discussion of a possible exception to the *Eisen IV* rule where fiduciaries were involved, referred to the existence of fiduciary duties between "the plaintiff and the defendant"—i.e. where there was a controversy between the two. However, the Fund is not a party to the class action claims, for no recovery is sought by plaintiffs from the Fund in the class action (Pet. Br. p. 35).

Plaintiffs seek to avoid the implications of these facts by pointing out (Resp. Br. p. 57) that although the Fund

is not a party to and has no controversy with plaintiffs in the class action, it does have an interest in the outcome by reason of the cross claims contingently asserted by the other defendants. These are to the effect that if defendants are found liable to the class by reason of overvaluations of restricted securities, then the Fund is liable to them to the extent it received excess funds from the class by reason of such overvaluation.[23] However, this argument further emphasizes the inequity of requiring the Fund to pay the notice costs here involved. If plaintiffs are unsuccessful, the Fund will have financed the suit and may or may not obtain reimbursement. If plaintiffs are successful, the Fund will receive no portion of the class recovery. On the contrary, by reason of the cross claims, the Fund may be liable to the other defendants to the extent that it was unjustly enriched by overpayments from the plaintiff class.

It is indeed evident that the only financial interest of the Fund in this litigation is on a "heads you win, tails I lose" basis. This scarcely justifies requiring the Fund to pay out the moneys of its shareholders in order to exempt the plaintiffs from the "usual rule" enunciated by this Court, that "the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit." *Eisen IV*, 417 U.S. at 179.

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[23] A-67, A-89.

CONCLUSION

In view of the foregoing and for the reasons set forth in Petitioners' Brief, the judgment of the United States Court of Appeals for the Second Circuit should be reversed, with directions to vacate the order of the District Court insofar as it relates to the payment of the cost of identification of class members, and to require plaintiffs to bear these costs if they choose to continue the class action.

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Of Counsel:

GUGGENHEIMER & UNTERMYER
80 Pine Street
New York, New York 10005
(212) 344-2040

ALFRED BERMAN
LEON H. TYKULSKER
RICHARD P. ACKERMAN
NORMAN L. GREENE
80 Pine Street
New York, New York 10005
(212) 344-2040
Attorneys for Petitioners
Oppenheimer Management Corp.,
Oppenheimer & Co.,
Leon Levy,
Jack Nash

WEISMAN, CELLER, SPETT, MODLIN, WERTHEIMER & SCHLESINGER
425 Park Avenue
New York, New York 10022
(212) 371-5400

GERALD GORDON
425 Park Avenue
New York, New York 10022
(212) 371-5400
Attorneys for Petitioner
Oppenheimer Fund, Inc.

THACHER, PROFFITT & WOOD
40 Wall Street
New York, New York 10005
(212) 483-5800

JOHN F. DAVIDSON
DANIEL E. KIRSCH
40 Wall Street
New York, New York 10005
(212) 483-5800
Attorneys for Petitioners
Edmund T. Delaney,
Emanuel Celler